

Changes in Tax Residency Rules and interplay with FEMA residential status

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Presentation Layout

Sr. No.	Particulars
1	Background
2.	Changes to Residential Status under Income-tax
3	NRI Under FEMA
4	Interplay – Case Studies

Background

- ▶ Section 6 defines Residential status under Income-tax Act
- ▶ One of the most clear provisions across the world for a long time for determining residential status
- ▶ Simple and objective “number-of-days” test
- ▶ Threshold for NRIs visiting India increased from 90 to 150 to 181 days
- ▶ Led to abuse where NRIs effectively lived in India while claiming NRI status

- ▶ Massive changes brought in from Finance Act 2020 w.e.f AY 2021-22 (FY 2020-21) to counter such abuse
 - ▶ Mountain made out of a molehill

Resident & ordinarily resident of India (R&OR) for tax

- ▶ As per Sec. 6(1)
- ▶ Number of Days test
 - ▶ Simple unlike other countries
 - ▶ Also prone to abuse with many NRIs gaming the system by staying close to 181 days
- ▶ **Erstwhile conditions:**
- ▶ Resident if:
 - ▶ In India for more than 181 days during PY - 6(1)(a)
 - ▶ In India for more than 60 days during PY **and** 365 days during preceding 4 PYs - 6(1)(c)
- ▶ Relief provided by increasing threshold of 60 days to 181 days for:
 - ▶ Resident leaving India for the purposes of employment outside India
 - ▶ Resident Indian Citizen who has left India as member of crew on Indian ship
 - ▶ Issues for expats and sailors who continue for more than 181 days in year of departure

Amended Section 6(1)

6. For the purposes of this Act, —

(1) An individual is said to be resident in India in any previous year, if he —

(a) is in India in that year for a period or periods amounting in all to one hundred and eighty-two days or more ; or

(b) [***]

(c) having within the four years preceding that year been in India for a period or periods amounting in all to three hundred and sixty-five days or more, is in India for a period or periods amounting in all to sixty days or more in that year.

Explanation 1 — In the case of an individual, —

(a)

(b) being a citizen of India, or a person of Indian origin within the meaning of *Explanation* to clause (e) of [section 115C](#), who, being outside India, comes on a visit to India in any previous year, the provisions of sub-clause (c) shall apply in relation to that year as if for the words "sixty days", occurring therein, the words "one hundred and eighty-two days" had been substituted **and in case of the citizen or person of Indian origin having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year, for the words "sixty days" occurring therein, the words "one hundred and twenty days" had been substituted**

Explanation.-For the purposes of this section, the expression "income from foreign sources" means income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India).

Deemed Resident u/s. 6(1A)

- ▶ **New sub-section introduced from 1.4.2020**
- ▶ **Notwithstanding anything contained in clause (1) an individual, being a citizen of India, having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year shall be deemed to be resident in India in that previous year, if he is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.**
 - ▶ **Explanation. – For the removal of doubts, it is hereby declared that this clause shall not apply in case of an individual who is said to be resident in India in the previous year under clause (1).**
- ▶ **Paired with introduction of new category of NOR status**
- ▶ **Result is deemed residents will perpetually be NORs**
- ▶ **Applicable only if individual remains NR even under Sec. 6(1)**
 - ▶ **Explanation inserted by the Taxation And Other Laws (Relaxation And Amendment Of Certain Provisions) Act, 2020**

Amended Section 6(6)

- ▶ 6. For the purposes of this Act, —
- ▶ (6) A person is said to be "not ordinarily resident" in India in any previous year if such person is —
 - ▶ (a) an individual who has been a non-resident in India in nine out of the ten previous years preceding that year, or has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and twenty-nine days or less; or
 - ▶ (b) a Hindu undivided family whose manager has been a non-resident in India in nine out of the ten previous years preceding that year, or has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to, seven hundred and twenty-nine days or less; or
 - ▶ (c) a citizen of India, or a person of Indian origin, having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year, as referred to in clause (b) of Explanation 1 to clause (1), who has been in India for a period or periods amounting in all to one hundred and twenty days or more but less than one hundred and eighty-two days; or
 - ▶ (d) a citizen of India who is deemed to be resident in India under clause (1A).
- ▶ Explanation.-For the purposes of this section, the expression "income from foreign sources" means income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India).

Threshold limit

- ▶ New criteria for residential status are applicable only if:
 - ▶ Total income,
 - ▶ other than the income from foreign sources,
 - ▶ exceeds fifteen lakh rupees during PY

- ▶ “income from foreign sources” means income which accrues or arises outside India
 - ▶ And is not “deemed” to accrue or arise in India
 - ▶ Except income derived from a business controlled in or a profession set up in India

Issues on Threshold

- ▶ **Circular reference:**
- ▶ Amended Explanation refers to 'total income'
- ▶ Total income as per section 2(45) takes you to section 5
 - ▶ "total income" means the total amount of income referred to in section 5, computed in the manner laid down in this Act
- ▶ To determine scope of total income under section 5, you need to know the residential status
 - ▶ For determining inclusion of certain exempt incomes like FCNR interest, etc.
 - ▶ For determining computation of certain taxable incomes like capital gains, etc.
 - ▶ For determining incomes as per tax treaty, if applicable
- ▶ Counterview- consider Total income definition without recourse to Section 2(45) as it is not in context
 - ▶ Total income as per generic understanding
 - ▶ Exempt incomes to be considered? Agricultural income, partnership profits, etc.
 - ▶ Capital Gains not to be considered??
- ▶ No clarification will be provided

RNOR Status

- ▶ Unique residential status– a gift of British Raj
- ▶ For Individuals and HUFs erstwhile categories, which continue:
- ▶ RNOR means a person resident in India but who has been:
 - ▶ NR for 9 out of preceding 10 PYs; or
 - ▶ Who has spent less than 729 days in the preceding 7 PYs
- ▶ RNOR status can thus be enjoyed for a max period of 3 PYs
- ▶ These RNOR statuses available to both Indian & Foreign citizens

- ▶ **New categories, with effect from 1st April 2020:**
- ▶ RNOR also includes an Indian citizen covered u/s. 6(1) who spends more than 120 days in India and fulfils the specified conditions; and
- ▶ RNOR also includes an Indian citizen covered u/s. 6(1A) who is not liable to tax in any other country due to his domicile, residence, etc.

Benefit:

- ▶ Only incomes received or accrued in India taxable for RNORs
 - ▶ Incomes earned, accrued or received outside India not taxable in hands of RNOR
 - ▶ Scope of income taxable almost similar to that of NR
- ▶ However, incomes derived from a business controlled in, or a profession set up in India becomes taxable in India for RNOR

Scope of Income for RNOR under Section 5



*Income derived from Business Controlled in India or Profession Setup in India

Additional Income taxable for RNOR

- ▶ Scope of income as per Section 5(1) r.w. proviso includes:
- ▶ Income accruing or deemed to accrue in India
- ▶ Income received or deemed to be received in India
- ▶ **Income which accrues or arises outside India, but is “derived” from:**
 - ▶ a business controlled in India
 - ▶ a profession set up in India
- ▶ Limited increase in scope of taxable income for RNORs as compared to NRs
 - ▶ Intentional and targeted approach of Government
 - ▶ In line with the Press Release issued by Government on 2nd February 2020

Case Study – 1A – Profession set up in India

- ▶ Dr. Iyer, Indian citizen, has professional set up in India including clinic and staff, both secretarial and professional
- ▶ In FY 2019-20, he leaves India to stay with his son in UAE for good
- ▶ He manages his practice from UAE along with support of his staff in India
- ▶ In FY 2020-21 he comes on visits to India and stays for 140 days and stays in UAE for 170 days – balance days across other countries

- ▶ His total income of Rs. 17 lakhs for FY 2020-21 includes:
 - ▶ Medical fees from his Indian patients – Rs. 13 lakhs
 - ▶ Interest income from Indian bank accounts – Rs. 1 lakh
 - ▶ Medical fees from NRIs in UAE – Rs. 2 lakhs
 - ▶ Interest income from UAE bank accounts – Rs. 1 lakh

Case Study – 1A – Profession set up in India

- ▶ Impact analysis:
- ▶ Incomes accruing in India – Rs. 14 lakhs
- ▶ Incomes accruing outside India – Rs. 3 lakhs
- ▶ Incomes accruing outside India from a profession setup in India – Rs. 2 lakhs

- ▶ Taxable scope of Income – Rs. 16 lakhs - being more than Rs. 15 lakhs, he is covered by Section 6(1A) and would be RNOR as per 6(6)(d)
- ▶ **Medical fees of Rs. 2 lakhs accruing outside India liable to tax in India – u/s. 5(1) proviso**
- ▶ **Interest income from UAE Banks still not taxable**

Case Study – 1B - Profession set up 'outside' India

- ▶ Dr. Iyer, Indian citizen, understanding implications on his foreign incomes beforehand:
- ▶ Sets up a clinic in UAE on 1st April 2020
- ▶ He sets up clinic at his home in UAE
- ▶ He becomes member of local Medical associations in UAE and pays their membership fees
- ▶ He pays VAT on services supplied in UAE as applicable
- ▶ He manages his practice from UAE without support of his staff in India

- ▶ In FY 2020-21 he comes on visits to India and stays for 140 days and stays in UAE for 170 days – balance days across other countries
- ▶ His total income of Rs. 17 lakhs for FY 2020-21 includes:
- ▶ Medical fees from his Indian patients – Rs. 13 lakhs
- ▶ Interest income from Indian bank accounts – Rs. 1 lakh
- ▶ Medical fees from NRIs in UAE – Rs. 2 lakhs
- ▶ Interest income from UAE bank accounts – Rs. 1 lakh

Case Study – 1B - Profession set up 'outside' India

- ▶ **Impact analysis:**
- ▶ Professional income of Rs. 2 lakhs accruing outside India liable to tax in India?
- ▶ What would be considered as profession “setup” in UAE?
- ▶ Is a clinic/office required? Is staff required?
- ▶ Is a Home Office/clinic sufficient to constitute setup in UAE?
- ▶ Does local membership and payment of taxes play a role in determining set up?
- ▶ What if set up is done just before earning of foreign income? Can it be considered as an arrangement to avoid tax?

Case Study – 2A – Business controlled in India

- ▶ Mr. Ajwani is an Indian Citizen and residing in the UAE since 2006.
- ▶ Since he left India, he has been a non-resident of India up till FY 2019-20.
- ▶ His stay in India during FY 2020-21 is 180 days. Stay in UAE is 160 days. Balance days are spent in different countries due to travel.

- ▶ He has set up a proprietorship concern in UAE 'Ajwani & Co.' which is a trading business controlled by him throughout the year from India and UAE.
- ▶ He has an office in India and employees sitting in India for the execution of this proprietary business.

- ▶ His income for FY 2020-21 includes the following:
 - ▶ Interest on NRO account – Rs. 5,00,000
 - ▶ Profits of 'Ajwani & Co.' – Rs. 10,00,000.

- ▶ Impact Analysis:
 - ▶ Can the business be said to be controlled in India? Is part control to be considered?
 - ▶ If yes, what should be the amount of profits taxable in India?

Case Study – 2A – Business controlled in India

▶ **Impact Analysis**

- ▶ Can the business be said to be controlled in India? Is part control to be considered?
- ▶ Control not defined under the Act
- ▶ Reference can be made to decisions on expression “control and management” used for determining residential status of other persons
- ▶ Except that only the control aspect needs to be analysed and not management

- ▶ Business should be controlled in India
- ▶ From literal reading of the provision, if only partial control is in India the income of the business should not be covered

- ▶ However, implicit understanding given in **B B Iranee v CIT [1963] 50 ITR 366 (Bombay)** that even partial control in India would be sufficient to tax the income of the business in India

- ▶ If yes, what should be the amount of profits taxable in India?
- ▶ Once business is controlled partially, then only profits attributable to control in India should be taxable in India
- ▶ **B B Iranee v CIT [1966] 60 ITR 437 (SC):**
- ▶ As the control of the business is the condition for its application, it is argued that only so much of the income as accrues or arises to him without the taxable territories attributable to the period of such control is liable to tax. There appears to be some plausibility in this argument. (Obiter Dicta)

Case Study – 2B - Business controlled in India

- ▶ Same facts as 2A, but Mr. Ajwani has set up a LLC with his brother in UAE 'Ajwani & Bros.' which is a firm trading in diamonds
- ▶ The firm is controlled by their father who stays in India throughout the year. The brothers manage the sales business, but report to their father and take decisions from him
- ▶ His income for FY 2020-21 includes the following:
 - ▶ Interest on NRO account – Rs. 5,00,000
 - ▶ Profits from 'Ajwani & Bros.' – Rs. 10,00,000
 - ▶ Sales Commission from Ajwani & Bros. – Rs. 20,00,000
- ▶ **Impact Analysis:**
 - ▶ Can profits earned by Ajwani & Bros. be taxable in India?
 - ▶ Can the profits earned by Mr. Ajwani be taxable in India?
 - ▶ Can the sales commission earned by Mr. Ajwani be taxable in India?

Case Study – 2B - Business controlled in India

▶ **Impact Analysis:**

▶ **Can profits earned by Ajwani & Bros. be taxable in India?**

- ▶ No, even if Mr. Ajwani is RNOR, still liability of tax is on his own incomes, not incomes of the Firm.
- ▶ Section 5(1) provides scope of income taxable in the hands of the individual concerned
- ▶ However, liability can arise due to other provisions, namely 6(3)(ii) or PE under treaty, if applicable

▶ **Can the profits earned by Mr. Ajwani be taxable in India?**

- ▶ Business is controlled in India, but not by Mr. Ajwani
- ▶ Section 5(1) provides scope of income taxable in the hands of an individual
- ▶ Should control also be administered by him? Or can it be administered by anyone else in India?
- ▶ Kanga & Palkhivala's Law & Practice of Income-tax (Pg. 182, 7th Edition) seems to suggest that question of control of business arises only with reference to Individuals and HUFs as the proviso applies only to them

Case Study – 2B - Business controlled in India

- ▶ **Impact Analysis continued...**
- ▶ **Can the sales commission earned by Mr. Ajwani be taxable in India?**
- ▶ Only incomes **derived** from business controlled in India are taxable in India for RNOR
- ▶ Therefore, only direct incomes earned from the business are covered
- ▶ Or are indirect incomes earned due to services provided to business controlled in India also covered?

- ▶ Meaning of the phrase “derived from” business controlled in India needs to be studied
- ▶ No definition provided under the Act
- ▶ But several precedents under the Act:
 - ▶ Pandian Chemicals Ltd. v. CIT [2003] 129 Taxman 539 (SC)
 - ▶ “It is clear, therefore, that the word 'derived from' in section 80HH of the Income-tax Act, 1961 must be understood as something which has direct or immediate nexus with the appellant's industrial undertaking.”

Comparative table for NRs turning RNORs

Adverse Points

1. Limited increase in scope of income – income from business controlled or profession set-up in India
2. Concessional tax rates under Chapter XIIA and certain other exemptions available only to and NR not to NOR
3. Concessional tax rates under DTAA would not be available where India is a source country and individual tie-breaks in favour of India
4. Presumption that control of firm, HUF, company, etc., is in India - Erin Estate v CIT 34 ITR 1 - SC
5. Overall reduction in years of NOR relief to Returning NRIs
6. Clearly within tax compliance framework including TDS obligations, tax return filing, etc.

Beneficial Points

1. Slab rates available for senior citizens, etc., would be available to NORs.
2. TDS deduction not as per Section 195 lowering rates in most cases
3. Eligible to claim Foreign Tax Credit for doubly taxed incomes
4. Availing concessional tax rates under DTAA where India is a source country and individual tie-breaks in favour of foreign jurisdiction
5. Relaxation on reporting requirements (may not be required to file detailed ITR 2 as per extant provisions)
6. Access to India DTAA network in respect of foreign sourced incomes

Neutral Points

1. No obligation to report Foreign Assets
2. NOR to be treated as NR for determining AE relationship, and for the purposes of Section 93
3. No changes under FEMA residential status due to change in tax residential status

Person Resident in India – under FEMA

- ▶ Sec. 2(v) “person resident in India” means –
- ▶ (i) a person residing in India for more than one hundred and eighty-two days during the course of the preceding financial year but does not include –
- ▶ (A) a person who has gone out of India or who stays outside India, in either case –
- ▶ (a) for or on taking up employment outside India, or
- ▶ (b) for carrying on outside India a business or vocation outside India, or
- ▶ (c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;
- ▶ (B) a person who has come to or stays in India, in either case, otherwise than –
- ▶ (a) for or on taking up employment in India, or
- ▶ (b) for carrying on in India a business or vocation in India, or
- ▶ (c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period; ...
- ▶ Sec. 2(w) “person resident outside India” means a person who is not resident in India;

Meaning of NRI under FEMA

- ▶ From Feb. 2016, NRI has different meanings for different purposes.
- ▶ Non-resident **Indian citizens** are always considered as NRIs for all purposes.
- ▶ For Non-resident **Foreign citizens** to be considered as NRI, there are different criteria for different assets.
 - ▶ Criteria for Foreign citizens can be divided in following groups:
 - ▶ **Group 1:** Business & portfolio investment;
 - ▶ **Group 2:** Bank accounts, Deposits, Rupee loans to residents, rupee loans from residents under LRS, remittance under US\$ 1 mn. scheme, Insurance, etc.;
 - ▶ **Group 3:** Immovable property
 - ▶ Tabulated in next slide

Meaning of NRI – Comparative Analysis

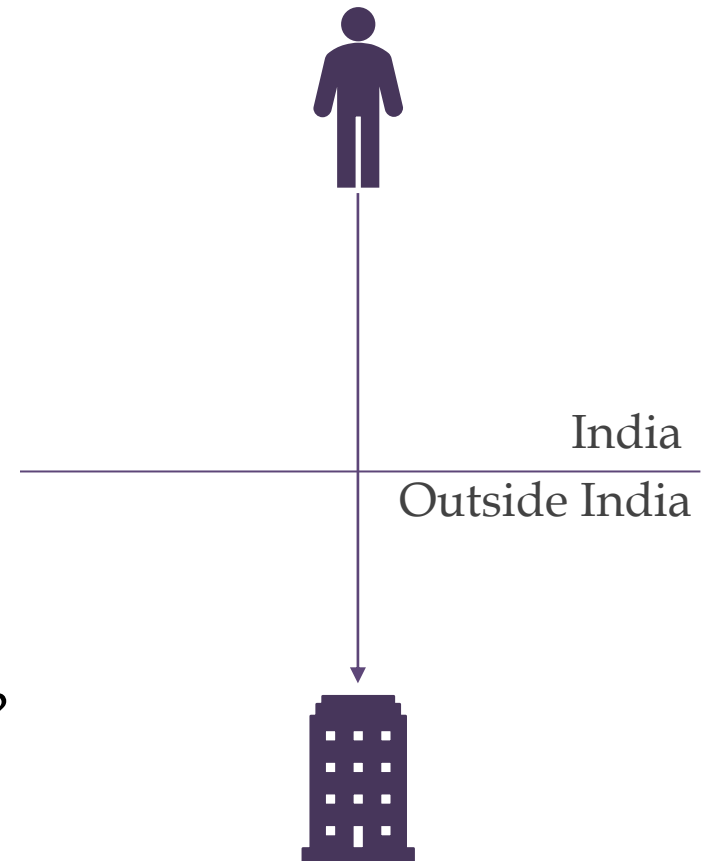
Particulars	Business and Portfolio Investment	Bank Accounts, etc.	Immovable Property
Eligible Foreign Citizens	<ul style="list-style-type: none"> OCI Cardholder (up to 4th gen.) Spouse of Indian citizen/OCI cardholder (if marriage subsisted for 2 years) 	<ul style="list-style-type: none"> OCI Cardholder PIOs (upto 4th gen.) Spouse of NRI 	<ul style="list-style-type: none"> PIOs (up to 3rd gen.)
Excluded Citizens	<ul style="list-style-type: none"> Bangladesh Pakistan 	<ul style="list-style-type: none"> Bangladesh Pakistan 	<ul style="list-style-type: none"> Spouse of NRI Bangladesh Pakistan Sri Lanka Afghanistan China Iran Nepal Bhutan
Remarks	PIOs should obtain OCI card to invest in India	This is the broadest definition of NRI	

Not Permanently Resident (NPR)

- ▶ NPR means a person resident in India:
 - ▶ For **employment of a specified duration** (irrespective of length thereof); or
 - ▶ For a **specific job or assignment**, the duration of which **does not exceed three years**.
- ▶ Indian employers can remit PF etc. abroad to those who are expatriate staff, i.e. whose PF, etc., is maintained outside India by the principal employer
- ▶ NPR Foreign citizen can remit net salary abroad
- ▶ NPR Indian citizen on “deputation” to Indian branch, Indian subsidiary or Indian JV company of foreign company can remit net salary abroad
 - ▶ Net salary means net of Tax, PF, etc.
- ▶ Life insurance policy can be issued in foreign currency or rupees
 - ▶ Premiums to be paid from abroad or from repatriable incomes

Case Study 3 - When does a person turn Non-resident?

- ▶ Mr. X has taken up employment in USA from 1st January 2022
- ▶ He was in India for the rest of the year
- ▶ Mr. X continues holding executive directorship in a company in India
- ▶ Mr. X wants to know his residential status for FY 2021-22.
- ▶ **Issues:**
 - ▶ Due to what reasons can he be considered NRI under tax and FEMA?
 - ▶ From what date does Mr. X turn NR under FEMA?
 - ▶ What are the safeguards he must employ on change of residence?
 - ▶ What are the implications?



Analysis of Case Study 3

- ▶ For NRI under income-tax:
 - ▶ Stay in India must be for less than 60 days in a year
 - ▶ Alternatively, he needs to leave India for the purposes of taking up employment abroad
 - ▶ In such a case he can become NRI even if he spends more than 60 days but less than 182 days in India
 - ▶ This relief is available **only to Indian citizens**
 - ▶ Tricky issue for employees who leave India post 30th September – 182 days condition not fulfilled
 - ▶ Manoj Kumar Reddy 12 taxmann.com 326 (Karnataka HC)
 - ▶ Will be considered NRI for the whole FY

- ▶ For NRI under FEMA:
 - ▶ Leave India for employment or business or vocation or for an uncertain period
 - ▶ NR from the date Resident left India for the above purposes

Analysis of Case Study 3

- ▶ FEMA residential status is most badly drafted definition
- ▶ Based on intent + facts
 - ▶ Number of days in India not relevant
- ▶ **Change of residence must be in substance**
- ▶ Employment involves:
 - ▶ Proper employment contract with Appointment letter
 - ▶ Appropriate employment/work visa
 - ▶ Monthly salary
 - ▶ Bank account receipts
 - ▶ Stay outside India with proof – Utility Bills
 - ▶ Dual employment
 - ▶ Clear Arrival & Departure stamps a must on passport
 - ▶ Date of travel
- ▶ Similar factors relevant for “business” and “uncertain period”

Analysis of Case Study 3

- ▶ Once employed abroad and NR
 - ▶ Person can open a bank account in foreign countries
 - ▶ Allowed to remit \$ 1 million from India every year
 - ▶ Immediate remittance on turning NRI should be avoided
- ▶ Post becoming NRI – Under tax:
 - ▶ Can come on **visit** to India and stay for 120 days (earlier 181 days)
 - ▶ Relief for **Indian citizens and PIOs**
 - ▶ Visit is not defined
 - ▶ Person coming for settling in India – May not qualify
 - ▶ Smita Anand 42 taxmann.com 336 (AAR)
 - ▶ Involuntary stay because of impounding of passport to be excluded from counting of days
 - ▶ Suresh Nanda 57 taxmann.com 448 (Delhi HC) – precedent value?

Analysis of Case Study 3

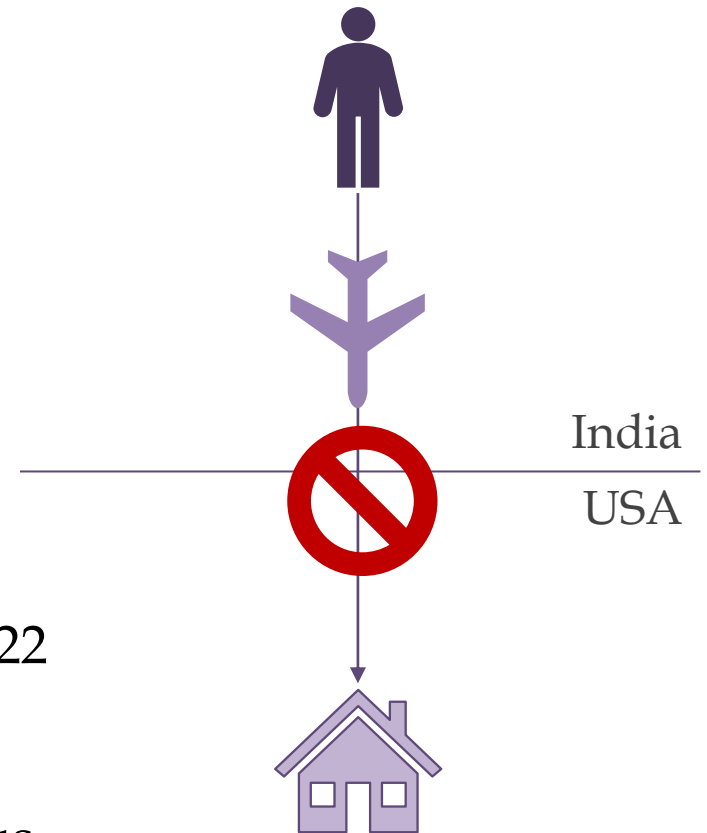
- ▶ Other things to be kept in mind
 - ▶ Bank accounts within India can be continued but need to be converted to NRO Account – Inform banks
 - ▶ Investments in shares, mutual funds, etc., can continue
 - ▶ Existing loan can continue till its original maturity
 - ▶ Banks, Companies, Custodian to be informed of change of residential status

Change of Residence under FEMA

- ▶ From R to NR:
- ▶ Section 6(5) of FEMA: A person resident outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India
- ▶ From NR to R:
- ▶ Section 6(4) of FEMA: A person resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.

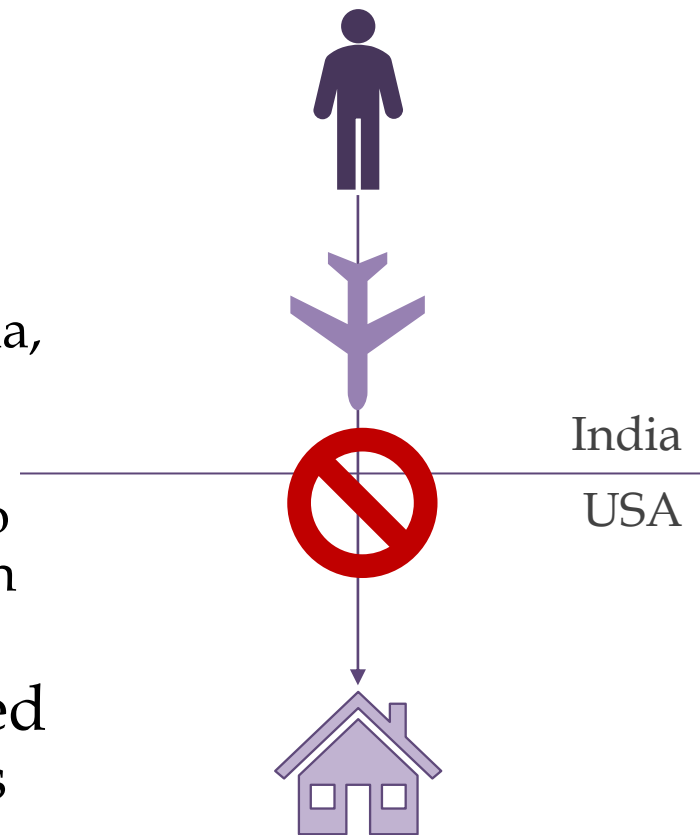
Case Study 4 - Involuntary stay in India

- ▶ Mr. A, resident of USA, visited India in March 2020
- ▶ Complete lockdown was announced on 24th March 2020
- ▶ Mr. A could not leave India
- ▶ Though lockdown was lifted in India later, Mr. A could not travel due to restrictions in USA
- ▶ Mr. A could finally travel back to USA only in November 2021
- ▶ Mr. A has received maturity proceeds from life insurance policy in January 2022
- ▶ **Issues:**
- ▶ What would be Mr. A's residential status in India for FY 2021-22?
- ▶ What would be implications on maturity proceeds received?



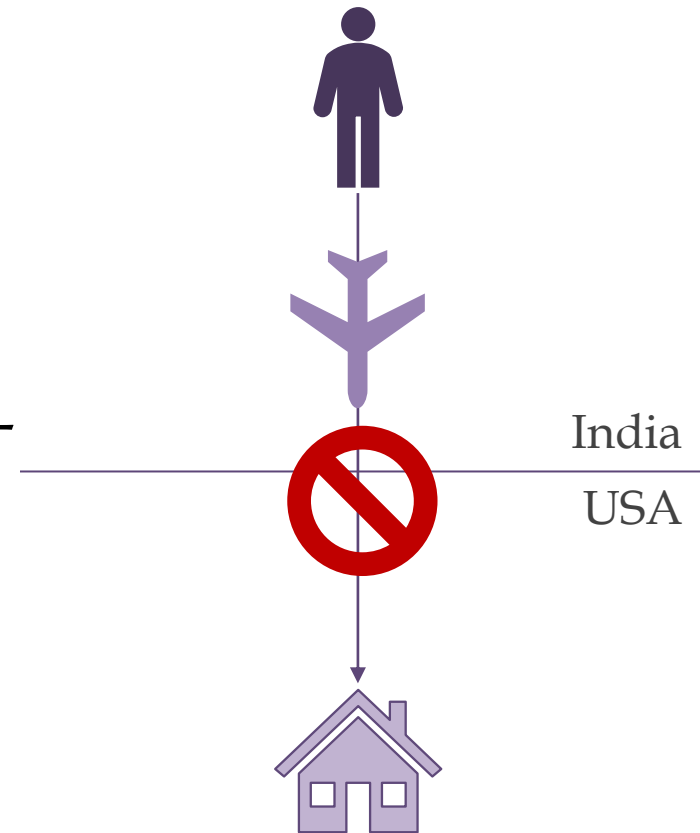
Case Study 4 - Involuntary stay in India

- ▶ Determination of Residential status:
- ▶ Under FEMA status based on intent + facts:
 - ▶ Mr. Y did not intend to settle in India, did not take up employment or do business
 - ▶ Mere stay in India would not lead to him becoming Resident even though he crossed 182 days
- ▶ However, he would be considered resident in India for tax purposes
 - ▶ RNOR if Section 6(6) conditions met
- ▶ **Thus RNOR under tax but NR under FEMA**



Case Study 4 - Involuntary stay in India

- ▶ Different status under both laws can create issues
 - ▶ NRE interest exemption
- ▶ **On maturity proceeds:**
- ▶ TDS as per domestic provisions – 194DA
- ▶ Remittance as per NR under FEMA:
 - ▶ In proportion of premia paid in foreign currency in relation to total premia
 - ▶ Permitted to credit the proceeds to NRE/FCNR account



Insurance Premia and Settlements under FEMA

Issue	Non-Resident	Not Permanently Resident	Resident - Returning NRI
Can Policy be issued in Foreign currency?	Yes, if premia are collected in foreign currency from abroad or out of NRE/FCNR accounts of the insured or his relatives held in India.	Yes, only to foreign nationals not permanently resident in India provided the premia are paid out of foreign currency funds or from their income earned in India or repatriable superannuation/pension fund in India.	Yes, only to Indian nationals or PIOs provided premia are paid out of remittances from FC funds held by them abroad or from their RFC accounts.
Settlement of claims in INR or FC?	<p>On INR policies in proportion of premia paid in foreign currency in relation to total premia.</p> <p>On FX policies in FC in NRE/FCNR account</p>	Paid in INR or allowed to be remitted abroad if the claimant so desires.	Permitted to open and credit the proceeds to their RFC Account.

Case Study 5 – Liable to tax

- ▶ Ms. Y is a resident of Bahrain
- ▶ Ms. Y has not stepped in India for even 1 day in FY 2021-22
- ▶ Her income for FY 2020-21 includes the following:
 - ▶ Interest on NRO account – Rs. 5,00,000
 - ▶ Capital Gains on sale of shares of listed Indian companies – Rs. 6,00,000
 - ▶ Dividend from Indian Companies – Rs. 5,00,000
- ▶ She is employed with a Bahrain based consultancy firm (controlled by Bahrain residents) and is earning a salary of Rs. 24,00,000. She did not work when she was in India
- ▶ Is she considered resident of India?



Bahrain

India

Case Study 5 – Liable to tax

- ▶ Ms. Y should be regarded as a “Deemed Resident” as per section 6(1A) although her stay in India zero days
- ▶ Deemed Resident will be considered as R but NOR of India as per S. 6(6)(d)
- ▶ Loss of concessional rate of tax due to NOR status vis-à-vis an NR as per the Act
- ▶ Salary income not liable to tax in India
- ▶ The treaty implications would be as under:
 - ▶ Resident of India under Article 4(1)
 - ▶ Non-resident of Bahrain – ‘liable to tax’ condition
 - ▶ Concessional rate under treaty not available for Interest income and dividend income as India will be COR



Bahrain
India

Liable to Tax

- ▶ Section 6(1A) applies to a concerned individual only :
- ▶ *“if he is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.”*
- ▶ S. 2(29A) defines “liable to tax”:
- ▶ "liable to tax", in relation to a person and with reference to a country, means that **there is an income-tax liability on such person under the law of that country** for the time being in force and shall include a person who has subsequently been exempted from such liability under the law of that country
- ▶ Countries where there are no taxes on individuals may fall out of definition of “liable to tax”
- ▶ UAE, Saudi Arabia, Oman, Qatar, Bahrain, Kuwait, Cayman Islands, Brunei, BVI, Monaco
- ▶ Corporate income tax in UAE from 2023 – will it change position?

Liable to Tax - Jurisprudence

- ▶ **M.A. Rafik - Advance Ruling - December 1994 (213 ITR 317):**
- ▶ UAE DTA applies even if there is no income tax liability in UAE for individuals.
- ▶ “Given the clear knowledge on the part of India that individual Indian investors in UAE have to pay no, or only a nominal, income-tax on their income, the only purpose of the Agreement was to provide some benefits to all UAE investors in India.”

- ▶ **Cyril Pereira - Advance Ruling - May 1999 (239 ITR 650):**
- ▶ UAE DTA cannot apply as there is no tax liability in UAE for individuals. A person should be “subject to tax” under the UAE tax law.
- ▶ “But if that individual does not have to pay any tax on the income in the U.A.E. because there is no local tax leviable in the U.A.E. on the income of an individual, no question of granting relief under the Double Taxation Avoidance Agreement in respect of such income can arise in the course of assessment of his income in India.”

- ▶ **Emirates Fertilizer Trading - Advance Ruling - October 2004 (272 ITR 84):**
- ▶ UAE DTA applies.
- ▶ “It follows that in view of the provisions of para. 3 of article 13 of the treaty, the capital gains arising to the applicant can be taxed only in the UAE and not in India and that their taxability under the Act in India does not depend upon whether they are as a fact taxable in the UAE.”

Liable to Tax - Jurisprudence

- ▶ **Abdul Razak A. Meman - Advance Ruling - May 2005 (276 ITR 306):**
- ▶ UAE DTA cannot apply to individuals. Therefore Capital gains article cannot apply.
- ▶ “The applicant, an individual, residing in UAE is not entitled to claim the benefit of the provisions of the treaty entered into between India and UAE.”
- ▶ However interest and dividend articles will apply due to CBDT circular!

- ▶ **Green Emirates Shipping and Travels - Mumbai Tribunal - November 2005 (286 ITR 60):**
- ▶ UAE DTA applies.
- ▶ “Irrespective of whether or not the UAE actually levies taxes on non-corporate entities, once the right to tax UAE residents in specified circumstances vests only with the Government of UAE, that right, whether exercised or not, continues to remain exclusive right of the Government of UAE.”

- ▶ **Meera Bhatia v. ITO [2010] - Mumbai Tribunal - 1 taxmann.com 52 (M UM . - ITAT) - Oct 2010**
- ▶ UAE DTA applies.
- ▶ “We see no reasons to take any other view of the matter than the view so taken by the co-ordinate bench in the case of Green Emirates Shipping & Travels (supra). It may result in double non taxation but then we cannot be oblivious to the fact that double non-taxation is also a fact of life, and tax sparing, which find place in several Indian tax treaties, are also a reality in international taxation.”

- ▶ **In the context of Mauritius treaty, where capital gains are not liable to tax, Azadi Bachao Andolan [2003] 263 ITR 703 (SC) held:**
- ▶ Liability to taxation is a legal situation payment of tax is a fiscal fact For the purpose of application of Article 4 of the DTAC, what is relevant is the legal situation, namely, liability to taxation, and not the fiscal fact of actual payment of tax If this were not so, the DTAC would not have used the words 'liable to taxation', but would have used some appropriate words like 'pays tax' (Para 85)

Residence under treaty

- ▶ A person resident outside India and resident under the Act due to the new clauses would end up being dual resident in most cases
- ▶ In such a case, if a treaty is available between the two countries, residence for the purposes of tax treaty would be determined as per the “tie-breaker” test
- ▶ Tie-breaker test is a series of tests to determine treaty residence
- ▶ Determines residence as per treaty
 - ▶ Resident of another country as per treaty would lead that person to be a non-resident of India leading to taxation only of Indian sourced incomes
 - ▶ Scope of taxability narrower than that for even RNORs
 - ▶ However, compliance requirements for Residents still stand
 - ▶ Need to file tax return to claim this treaty relief
 - ▶ Need TRCs of both countries to claim dual resident status
- ▶ Documentation very important for tie-breaker test


Case Study 6 – Dual Resident

- ▶ Ms. Z, a citizen of India, is a resident of UAE
- ▶ Ms. Z has not stepped in India for even 1 day in FY 2021-22
- ▶ Ms. Z has been in UAE for the whole of 2021
- ▶ She does not have a house in India. She has a rented home in UAE where she has been living since 2016.
- ▶ Her income for FY 2020-21 crosses the threshold
- ▶ Income includes capital gains and NRO and NRE interest
- ▶ Is she considered resident of India as per treaty?
- ▶ What are the implications?



UAE
India

Article 4 of Treaties



DTAA benefit available only if the assessee is resident of one of the contracting states

Resident of a contracting state defined under Article 4(1) of the DTAA

Possibility of being resident of both the contracting states as per Article 4(1)

Tie breaker test under Article 4(2)

Article 4(1) of Treaties

- Liable to tax by reason of his domicile or residence or any other criteria of similar nature – comprehensive taxation

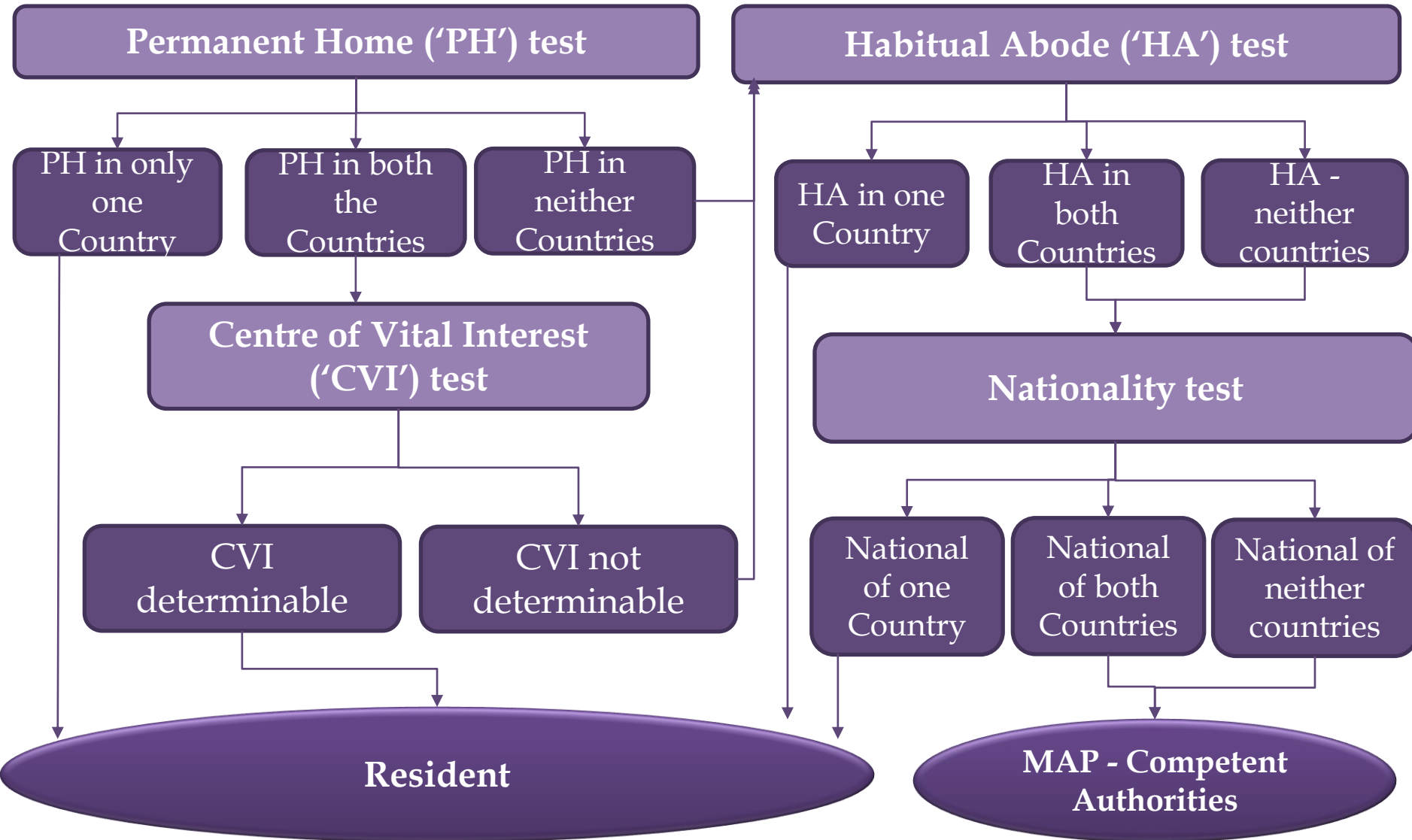
- Liable to tax vs. subject to tax

- Does not include any person who is liable to tax only in respect of income from sources in that State

- Some treaties prescribe number of days stay as a condition for residence under treaty – Eg. UAE, Kuwait.

- NOR whether comprehensively taxed?

Tie Breaker Rule



Tie-Breaker Test

▶ Permanent Home

- ▶ Can be any type of home, even rented. Should be in his possession
- ▶ Focus is on permanence, i.e., available for continuous stay as opposed to available only for a short or fixed duration or occasionally for example for study, holiday, business travel, etc.

▶ Centre of Vital Interest

- ▶ Factual exercise to be examined as a whole
- ▶ Important factors are family and social relations, occupations, political, cultural or other activities, place of business, etc.

▶ Habitual Abode

- ▶ Means the stay of that individual in each country without referring to the reasons for such stay
- ▶ Comparison should be over a sufficient period of time to ascertain in which country does the individual have his habitual abode

▶ National

- ▶ Determined based on the country of which the individual is a citizen
- ▶ Green Card or Residency Visa is not equivalent to nationality
- ▶ OCI Card holder is not a citizen of India

Case Study 6 – Dual Resident

- ▶ Ms. Z is a resident of India under Sec. 6(1A)
- ▶ She is also resident of UAE – Number of days presence
- ▶ Therefore **Dual Resident** of India and UAE

- ▶ Tie breaks in favour of UAE where she has a permanent home

- ▶ Loses concessional rate on Capital Gains not compensated by treaty
- ▶ Concessional rate under treaty available for Interest income

- ▶ HNIs considering changing citizenship due to tax impact

- ▶ For other treaties residence is still based on “Liable to tax” concept
 - ▶ Provision was subject matter of litigation in India for UAE residents with decisions going to and fro
 - ▶ Now UAE residents covered under treaty if they stay for 183 days or more in a calendar year
 - ▶ Further, 2(29A) defines “liable to tax” now which will aid interpretation under treaty too

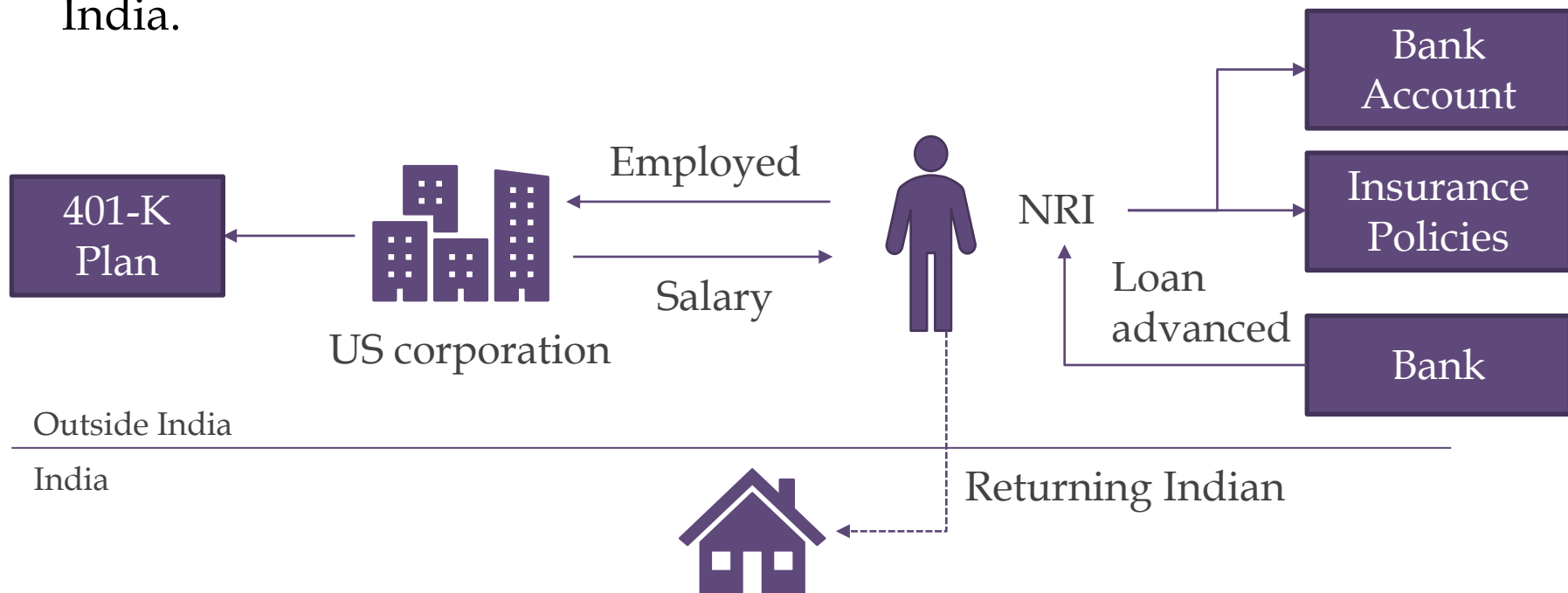


UAE

India

Case Study 7 - Returning Indian

- ▶ An NRI wants to return to India. He is having employment outside India and receives salary. Certain amount is being contributed to Pension Plan also. He has taken life insurance policies. He has also taken some loan from the bank.
- ▶ **Issue:** FEMA and Income-tax implications on returning back to India.



Analysis of Case Study 7 – Returning Indian

Income-tax Issues

- ▶ Incomes earned abroad need to be offered for tax in India after he turns R&OR
 - ▶ Check residential status as per relevant DTAA
 - ▶ Tie-breaker test to be checked

- ▶ Salary income generally taxable in country where services rendered under DTAA

- ▶ PF Accounts (401-K)
 - ▶ Income credited to PF Account – Taxable in India in same year
 - ▶ On withdrawal of Capital on seniority – Capital not taxable
 - ▶ Issue of Foreign Tax Credit for taxes paid in USA on withdrawal while incomes offered to tax every year
 - ▶ Disclosures required in Schedule FA of investments made under 401-K plan

- ▶ Joint Returns filed
 - ▶ Proper division of income
 - ▶ Issue of Foreign Tax Credit

Analysis of Case Study 7 – Returning Indian

FEMA Issues

- ▶ FEMA permits Returning Indian to retain foreign assets abroad and continue foreign businesses subject to conditions
- ▶ Indian assets will become “Non-repatriable”
- ▶ NRE Account to be converted to resident account
 - ▶ Transfer can be made to RFC Account
- ▶ Life Insurance policies taken from abroad
 - ▶ Can be continued
 - ▶ Premiums to be paid from foreign account, RFC account or LRS
- ▶ Repayment of foreign loans
 - ▶ Law not clear
 - ▶ No objection from RBI if payment from foreign or other remittable funds

Various terms for status of non-resident

- ▶ **Resident / Non-resident**
 - ▶ For Income-tax and FEMA
- ▶ **Deemed Resident**
 - ▶ New category for Indian citizens from non-taxed countries
- ▶ **Not Ordinarily Resident (NOR)**
 - ▶ This is relevant under Income-tax for exemption of foreign income
- ▶ **NRI and NR**
 - ▶ For Income-tax and FEMA
- ▶ **OCI (Overseas Citizen of India)**
 - ▶ This is different from “citizenship”. It is relevant for FEMA (apart from visa etc.)
- ▶ **PIO (Person of Indian Origin)**
 - ▶ For Income-tax and FEMA
 - ▶ No fresh PIO cards are issued. Advisable to obtain OCI card. No specific relief for PIO card holders.

OCI cardholders can be PIOs.
But PIOs are not automatically OCIs.

Various terms for status of non-resident

▶ **Returning Indian**

- ▶ This is relevant under FEMA and means a person who was a non-resident and has now returned to India and become an Indian resident
- ▶ It is relevant for exemption under FEMA for foreign assets – Section 6(4)

▶ **Not permanently resident**

- ▶ Relevant under FEMA for exemption from FEMA for Indian residents

▶ **Citizenship**

- ▶ Relevant for some issues under FEMA and Income-tax. (Sometimes “Nationality” is used in place of citizenship.)

▶ **Domicile**

- ▶ Criteria to determine liability to tax in certain countries
- ▶ Relevant for estate duty in foreign countries.

Way Forward

- ▶ Several relaxations under FEMA for NRIs
- ▶ However, not many tax reliefs for NRIs now
- ▶ Residential status now a challenge
- ▶ More and more scrutiny of NRIs
 - ▶ Documents need to be maintained for source on return to India
- ▶ Care needs to be taken in relation to change of residence
- ▶ NRI status cannot be misused
 - ▶ GAAR – AO has power to ignore change of residence
- ▶ Change of residential status for companies too from AY 2017-18 – Place of Effective Management introduced
 - ▶ Restricted applicability due to exemption till Turnover of Rs 50 crores

Thanks!

▶ Questions?

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